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BANKING TRANSACTION TAX

AUTHORED BY - RITWICK MAJUMDER

ABSTRACT

IN THE PREVIOUS SEVERAL DECADES, the Indian economy has undergone a shift that has made the country's tax system overhaul necessary. It is vital to have a functional and streamlined tax system in the period of accelerating globalisation in order to boost revenue, decrease economic imbalances, and foster a competitive economic climate.

With the requirement of tax reforms, a recommendation for the implementation of a single tax known as the **Bank Transaction Tax (BTT)** was suggested.

In this essay, the implementation of the bank transaction tax in India is critically evaluated. The study makes an effort to examine the difficulties and possibilities facing the government with regard to the ramifications of BTT, as well as its effects on those who are paid a salary, businesses, and industry.

LITERATURE REVIEW

The Rates and Revenue of Bank Transaction Taxes authored by **Jorge Francisco Baca Campodonico, Luiz R. De Mello, Andrei A. Kirilenko** highlights the concept of banking transaction tax. This research paper provides nationwide concrete evidence of the effectiveness of bank transaction levies. The date of sis South American countries have been considered who have implemented the concept of BTT in their economic system. The study shows that the revenue decreases over time for a certain tax rate. Consequently, the tax rate must be hiked continually in order to achieve a set revenue objective in real terms. This is true regardless of how high the tax rate is raised. We come to the conclusion that BTTs, particularly over the longer term, do not provide a stable source of revenue.¹

¹ Luiz R. de Mello, Andrei A. Kirilenko, *The Rates and Revenue of Bank Transaction Taxes*, OECD, Economics Department, OECD Economics Department Working Papers(2006).

14 Impact of The Bank Transactions Tax on Deposits in Argentina authored by **Ricardo Fenochietto, Carola Pessino, Ernesto Crivelli** highlights the implications of Banking Transaction Tax system in Argentina specifically which introduced the system in late 1980s. This tax was introduced during a crisis with an objective to boost revenue collection. This study uses several cointegration-based econometric models to assess how the BTT would affect savings and checking account deposits in Argentina. The results show that the tax will have a considerable negative impact on the amount of deposits.²

RESEARCH QUESTION

- Whether Banking Transaction Tax system can suitable for a developing nation like India or not?
- Whether the concept Banking Transaction Tax was successful in other developing countries or not?
- Whether BTT can replace Income Tax in India or not?

RESEARCH OBJECTIVE

The objective behind writing the research paper '**Banking Transaction Tax: A Critical Appraisal**' is to understand

- a) The concept of banking transaction tax
- b) To provide the reader with a basic understanding of the advantages and disadvantages of BTT in Indian Scenario.
- c) To determine the practical aspect of BTT system.

INTRODUCTION

'There are only two things in life that are guaranteed: death and taxes.'

- **Christopher Bullock**

² 14 Impact of The Bank Transactions Tax on Deposits in Argentina, Ricardo Fenochietto, Carola Pessino, Ernesto Crivelli

INDIA'S TAX STRUCTURE has to be reformatted as a result of the dramatic upheaval the Indian economy has seen in recent decades. An efficient tax structure is necessary for the development of a nation. In **Kautilya's Arthashastra**, a sound state treasury is advised. It is significant since economic growth heavily rely on it.

Tax reform is urgently needed in India due to the complicated tax system there. The main concerns with tax changes include lowering the intricacy of the current tax system, the expense of tax levy and collection across various tiers, and offering solutions for tax dodging. A proposal to impose a single tax known as the BTT was made in response to the need for the aforementioned tax reforms.

It is not a novel notion to push for a single tax. **For the first time, France proposed imposing a single tax.** Brazil, nevertheless, also suggested single tax in a different structure, called BTT, in the 1990s, along with discussion on single tax in the 19th century between Canada and the United States. In the **fiscal year 2005-06**, the concept of single tax was brought with a purpose of eliminating the creation of black money. The concept, nevertheless, was divisive and received harsh criticism. After a long absence, the idea of a single tax was revived and made more extreme. As per many leaders the present tax system act as a burden for common citizen. The **Pune-based research organization Arthakranti** is well-known across the nation for its advice to the Prime Minister. It asserts responsibility for last year's historic demonetization of Rs. 500 and Rs. 1000 notes. It serves to offer well studied methodological approaches intended to totally alter the existing socio-economic situation in India.

BANKING TRANSACTION TAX

BTT is founded on the concept that, in a "**monetized economy**" like the one we live in, banking transactions, including credit and debit ones, serve as the foundation for all value exchanges. As a result, the tax can be charged by introducing a charge to all financial transactions. Every type of **financial transaction, including paper checks and electronic ones**, will have a two percent fee, as according Arthakranti. In varied amounts, the centre, the states, and the local governments might be held responsible for this fee.

According to Arthakranti's formula, local bodies **receive 0.35 %**, **the States receive 0.6 %**, **and the Center receives 0.7 %**. The remainder of this sum would likewise be credited to the bank doing the actual business.

This approach applies to banking transactions since all credits and receipts, regardless of their intended use, are subject to tax. **Assuming that high value transactions will be processed by banks and that only the impoverished will utilise money, cash payments have been excluded from this system.** The transfer of funds between two bank accounts that belong to the same individual is another exemption. In certain circumstances, a direct payment mechanism may be used to repay the tax. It is also suggested that, in order to offer people a single, distinct identity and avoid the abuse of exclusions to BTT, Aadhaar or PAN cards be linked to people's bank accounts.

THE PROPOSAL OF BANKING TRANSACTION TAX

BTT PROPOSAL

Abolition of the present tax system.

Every bank transaction will attract a single point tax (2%) which will be deducted at the source.

This taxed amount will be credited to various levels of government, including the federal, state, and local, in a suitable proportion.

As a significant agent and facilitator, the transacting bank will also receive a portion of this sum (about 17.5%).

Removal of large bills (such as the 100-, 500-, and 1000-rupee notes).
Transaction taxes will not apply to cash transactions.

The government should enact legislation to limit cash transactions to a particular amount (given Rs. 2000)

OPPORTUNITIES AND LIMITATIONS OF BTT SYSTEM

OPPORTUNITIES

LIMITATIONS

<p>The complex tax structure in India would be made simpler with the adoption of BTT.</p>	<p>The inequality gap would expand if taxes are levied on the wealthiest and the poor at the same rate.</p>
<p>It will simplify and streamline documentation while removing opportunities for financial crimes, exploitation, and evasion.</p>	<p>Because it would need many taxes to accomplish a single operation, the BTT also has a cascading impact on economic activity.</p>
<p>The BTT's ability to filter high-value transactions exclusively via banks would contribute in the battle against black money and money laundering.</p>	<p>Additionally, if the same amount of money is transferred across several family accounts numerous levels of taxation will be applied to the transaction.</p>
<p>It will encourage individuals to pay taxes fairly.</p>	<p>Businesses could relocate their payment centre out of India and consider using offshore bank accounts in order to avoid paying bank transaction tax.</p>
<p>It will alter the way that individuals do business, moving away from cash transactions and promoting a check-based economy that encourages more accountability.</p>	<p>BTT being a flat tax is regressive in nature.</p>

BTT's CONCEPT IN LATIN AMERICAN COUNTRIES

SIX LATIN AMERICAN COUNTRIES SUCH AS BRAZIL, ARGENTINA, ECUADOR, BOLIVIA at the end of 2004 introduced the concept of BTT. When there is an economic crisis or in reaction to one, BTTs are typically adopted as a last resort to raise money. All of the taxes were implemented temporarily before being, in some circumstances, further expanded. Tax rates have varied greatly throughout time and among countries, ranging from **0.2% to 2.0%**. In addition, most nations have not consistently imposed BTTs.

Additionally, each nation has a different list of banking transactions that are taxed. Most of the time, only bank debits—including check clearance, withdrawals, and debt payments subject to taxes.

From 2001-2004, both Ecuador and Argentina taxed the bank credit. The same practice was followed in Columbia during 1990-2004. Most nations have tax exemptions for specified organization (such as government entities and nonprofits) and transactions (such as those with the central bank and between federal agencies).

BTTs' revenue results have been highly variable. With yearly revenues between 0.6 and 1.6% of GDP and effective taxes ranging between 0.2 and 0.38 %, it has been notably significant in Brazil and Colombia. However, BTT productivity has generally been on the decline, as indicated by the magnitude relation of revenues to GDP to the average statutory rate.

COUNTRY	YEAR	EFFECTIVE RATE	COLLECTION IN % OF GDP	PRODUCTIVITY
ARGENTINA	1988	0.70	0.83	1.18
	1989	0.70	0.66	0.94
	1990	0.30	0.30	0.99
	1991	1.13	0.91	0.81
COLUMBIA	1999	0.20	0.71	3.54
	2000	0.20	0.60	2.89

BRAZIL	2001	0.30	0.75	2.50
	2002	0.30	0.71	2.37
	1994	0.25	1.28	5.10
	1997	0.20	0.86	4.28
	1998	0.20	0.89	4.44
VENEZUELA	1999	0.38	1.40	3.69
	1994	0.75	1.30	1.73
	1999	0.50	1.13	2.26
PERU	2000	0.50	0.89	1.78
	1990	1.42	0.89	0.63
	1991	0.81	0.58	0.71 ³

PRACTICAL IMPLICATIONS OF BTT

The practicality of Banking transaction tax system in modern economy is shown below with the help of a table:

COST PRICE	PROFIT %	SELLING PRICE	BTT (2%)	TAX AS % OF PROFIT
200	5	205	4.1	82
200	10	210	4.2	42
200	20	220	4.4	22
200	100	300	6	6
200	200	400	8	4

*All the data are in rupees & hypothetical

Calculations:

SP= CP+ PROFIT %

BTT= 2% OF S.P.

TAX AS % OF PROFIT: BTT/ PROFIT *100

³ Luiz R. de Mello, Andrei A. Kirilenko, *The Rates and Revenue of Bank Transaction Taxes*, OECD, Economics Department, OECD Economics Department Working Papers(2006).

CRTICAL ANALYSIS

The following table is used to examine the effects of the proposed BTT, and it reveals that different industries have varied profit margins for various products.

As from the table one can easily deduce that a product with less profit margin were taxed as higher rate while products with high profit margin they are taxed less. For example: Product with profit margin of 5% are taxed at 82% while product with a profit margin of 200 % are taxed at 4%.

OPINION

Economy is the foundation of a strong nation. A sound tax system contributes a lot to the economy. **Any taxation system must accomplish the following fundamental goals:**

1. It must adhere to the law, as our constitution prohibits the accumulation of money and power and is inherently socialist.
2. It must guarantee the government receives enough revenue.
3. It needs to be durable and evolve over time.
4. In an automated tax collecting system, there cannot be a sizable, ineffective bureaucracy.
5. If BTT is implemented, all transactions must be subject to the same tax rate in order for it to be administered.

We have a significant cash economy, with over 70% of our economy being unorganized. The organised sector just pays the BTT, which is the first negative effect. If using bank for transaction cost more, then people might choose to switch to cash transactions. It is not possible to outright prohibit cash transactions. Even if the government does that, it will collapse. Unlike income tax, BTT is not subject to discretion. Rich individuals pay a higher income tax rate than poor ones do. All parties pay equally under BTT. As a result, discrepancies will grow fast and drastically.

BTT is calculated based on the number of transactions. In a struggling economy, it may be extremely detrimental if cash flow becomes constrained and payments are delayed. It is challenging to predict what will happen to global trade, which accounts for a sizable share of

total trade. BTT will destroy global trade. Another problem with BTT system is that, it is inflammable in nature and will hike the price immediately. BTT is indeed a very radical shift which is not suitable for India right now.

Until the majority of the population (over 90%) in India joins the organised sector, in my opinion, BTT may not be currently relevant or a practical option. This too solely pertains to the topic of how taxes are collected. A one-size-fits-all approach would not be wise as a volume game-based method of tax collecting.

CONCLUSION

The National Institute of Public Finance and Policy has already evaluated the efficiency of BTT system in a report and concluded that the system doesn't look promising. The report contends that BTT does not uphold equality, a crucial taxation element. The existing structure values progress. It has somewhat lower taxes on products and services used by the poor than on other commodities and services.

Additionally, the income is gradually taxed. Incorporating the equality concept into BTT would be challenging because it is ingrained in our existing system. NIPFP also feels that BTT may not be as impenetrable as it appears. Earlier attempts at implementing such a tax were made in Argentina, and Brazil, where the flat tax system temporarily increased income but had to be eliminated. Even if BTT system is adopted a highly thorough foundation and clearly specified control mechanisms are needed.

SUGGESTIONS

1. India should work to convert its large unorganized sectors into organized ones. With the dominance of organized section BTT will be useless.
2. Along with the introduction of BTT system, the government should promote digital methods of payment.

3. Government should develop a mechanism to the citizens from using off-shore accounts for payment methods. If this is not controlled, then the government will suffer a lot after the implementation of BTT.
4. The BTT should be revised as the current system has a number of flaws in it. The inequality gap it creates should be addressed.
5. The banking industry need to be more technically refined and computerized. A nationwide mechanism for clearing checks and other papers should also exist.

